

ANALYSIS OF THE NEW JERSEY BUDGET

**TAX AND
REVENUE OUTLOOK**

FISCAL YEAR

2007 - 2008

NEW JERSEY STATE LEGISLATURE

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The FY 2007 and FY 2008 Tax and Revenue Outlook

Introduction

The Office of Legislative Services (OLS) has prepared this report to assist the Senate Budget and Appropriations Committee and the Assembly Budget Committee as they develop the FY 2008 appropriations bill. The OLS revenue estimates reflect a careful review of current State revenue collections, revisions to statutory law, historic revenue collection patterns, and a variety of economic data and forecasts.

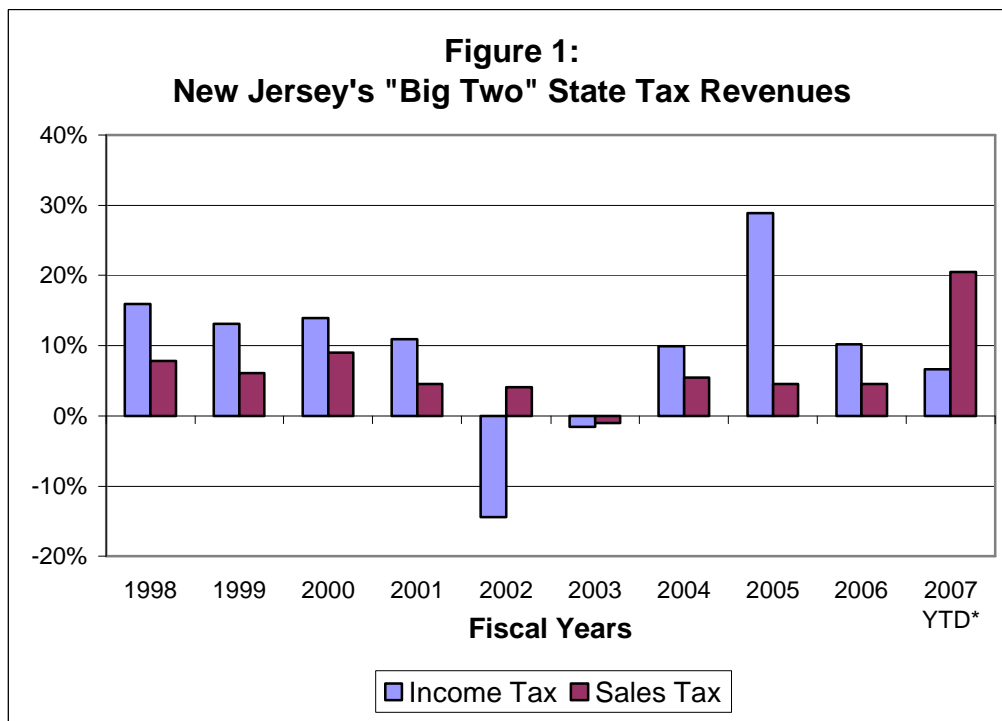
The OLS projects that FY 2007 and FY 2008 revenues will be \$625 million less than the estimates in the FY 2008 Governor's Budget Recommendation. Specifically:

- For FY 2007, the OLS revenue estimates are \$299 million below the Executive budget estimates (page 4).
- For FY 2008, the OLS revenue estimates are \$326 million below the Executive budget estimates (page 5).

The FY 2008 Budget Recommendation assumes few statutory changes to State revenues. The Governor has proposed an expansion of the New Jersey earned income tax credit. For the purposes of this report, the OLS assumes the tax policy change will be implemented, but believes it will reduce revenue by \$36 million rather than the \$64 million reduction assumed in the Governor's Budget message.

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Recap: FY 2007 Revenue Collections to Date



Each year the Office of Legislative Services provides the budget committees monthly updates of collections for 14 of the State's most important tax revenues. These revenues account for close to 90% of budgeted revenues. Moreover, nearly two-thirds of budgeted revenues come from the income tax and the sales tax alone. **Figure 1** and **Figure 2** display collections information through the end of February, seven months into FY 2007.

The **gross income tax** is growing by 6.7% above the same point last year, the third consecutive year of growth following the declines of FY 2002 and FY 2003. However, this year-to-date* growth remains below the Executive's target of a 9.1% growth rate for the entire fiscal year.

* Year-to-date (YTD) means receipts for July 2006 through February 2007. March figures should be available by the second week of April.

The **sales tax** is up 20.5% above receipts for the same period last year. Strong growth was expected due to the rate increase and base expansion enacted in July of 2006. However, growth remains below the Executive's year-end target of 24.5% growth.

The **corporation business tax**, the State's third largest revenue, is down 7.0% this fiscal year, slightly below the Executive's targeted decline of 4.5%.

Overall, through the first seven months of FY 2007, most State revenues are performing at or somewhat below the revised growth rates estimated in the Governor's Budget Message. The next few months will be crucial in determining if these trends will reverse. April and May are among the biggest collections months each year due to year-end tax filings and quarterly estimated payments from individuals and businesses.

Figure 2
FY 2007 Year-To-Date
Selected Revenue Comparison
Through the End of February 2007 vs. February 2006
Millions of Dollars

	FY 2006 Actual Through Feb.	FY 2007 Actual Through Feb.	Percent Change	Percent Change Target
Gross Income Tax	\$5,660.4	\$6,042.3	6.7%	9.1%
Sales Tax *	3,920.4	4,724.7	20.5%	24.5%
Corporation Business Tax	1,336.7	1,243.1	-7.0%	-4.5%
Lottery	553.1	512.5	-7.3%	-3.7%
Motor Fuels *	322.9	332.8	3.1%	2.7%
Motor Veh. Fees (Budgeted)	124.3	113.6	-8.5%	3.9%
<i>MV Fees (Total) **</i>	<i>319.1</i>	<i>312.3</i>	<i>-2.1%</i>	<i>0.6%</i>
Casino	318.0	294.7	-7.3%	1.0%
Inheritance Taxes	403.6	402.8	-0.2%	-1.5%
Insurance Premiums	116.2	106.8	-8.1%	-4.7%
Cigarette (Budgeted)	376.4	23.7	-93.7%	-63.9%
<i>Cigarette (Total)***</i>	<i>531.4</i>	<i>526.6</i>	<i>-0.9%</i>	<i>1.6%</i>
Petroleum Products *	135.5	137.6	1.6%	2.7%
Alcohol Excise *	48.2	48.7	0.9%	1.1%
CBT -- Banks & Financials	60.1	36.8	-38.7%	-35.0%
Realty Transfer Fee *	287.0	229.2	-20.1%	-13.9%

Sources: Year-To-Date revenues are from Treasury's monthly cash reports.

The year-end Executive percentage change target is based on the February revised revenue estimates for FY 2007 contained in the proposed FY 2008 budget.

* Revenues represent seven months of cash collections. All others represent eight months of cash collections.

** Motor Vehicle Fees (Total) includes the off-budget dedication of \$194.8 million in FY 2006 and \$208.7 million in FY 2007 for the NJ Motor Vehicle Commission (P.L.2003, c.13).

*** Cigarette (Total) includes \$155 million deposited into the off-budget Health Care Subsidy Fund in FY 2006 and \$370 million deposited into the HCSF and \$201.2 million for debt service payments in FY 2007.

Fiscal Year 2007 Revenue Estimates

Figure 3
Fiscal Year 2007 Revenue Estimates
(\$ millions)

	<u>Appropriations</u> <u>Act Certified</u>	<u>Executive</u> <u>Revised</u> <u>Estimate</u>	<u>Executive</u> <u>Change</u>	<u>OLS</u> <u>Estimate</u>	<u>OLS vs.</u> <u>Executive</u> <u>Difference</u>
Gross Income Tax	\$11,475.0	\$11,465.0	-\$10.0	\$11,260.0	-\$205.0
Sales Tax	8,483.6	8,425.0	-58.6	8,375.0	-50.0
Corporation Business Tax	2,478.6	2,710.0	231.4	2,710.0	0.0
Insurance Premiums Tax	495.0	488.0	-7.0	470.0	-18.0
Realty Transfer Fee	415.0	396.0	-19.0	385.0	-11.0
Corp. Tax on Banks and Fin.	120.0	100.0	-20.0	90.0	-10.0
Cigarette Tax	215.0	228.1	13.1	223.1	-5.0
Other Revenues	6,942.3	7,010.7	68.5	7,010.7	0.0
Grand Total, All Funds	\$30,624.5	\$30,822.8	\$198.4	\$30,523.8	-\$299.0

See Appendix for additional detail. Numbers may not add due to rounding.

Figure 3 presents the FY 2007 revenue certification from the Appropriations Act (July 2006), the Executive's February revisions as presented in the Governor's Budget Recommendation, and the OLS forecast. Highlights of the revenue estimates include:

FY 2007 Executive:

- The Executive revised estimates for all revenues upward by a net \$198.4 million from the level certified in the FY 2007 Appropriations Act.
- The Executive estimate for the income tax is down \$10 million.
- The Executive estimate for the sales tax is down \$58.6 million.
- The Executive estimate for the corporation business tax is up \$231.4 million.
- The Executive estimates for four other major taxes are down by a combined \$32.9 million.
- The Executive estimates for all other revenues are up by a combined \$68.5 million.

FY 2007 Office of Legislative Services:

- The OLS total revenue estimate for FY 2007 is **\$299 million below** the Executive's revised projection.
- The OLS estimate for the income tax is \$205 million below the Executive's.
- The OLS estimate for the sales tax is \$50 million below the Executive's.
- The OLS estimate for the corporation business tax is the same as the Executive's.
- The OLS estimates for the four other major taxes are \$44 million below the Executive's.
- The OLS estimates for all other revenues are the same as the Executive's.

Fiscal Year 2008 Revenue Estimates

Figure 4
Fiscal Year 2008 Revenue Estimates
(\$ millions)

	<u>Executive</u> <u>Estimate</u>	<u>Annual Growth</u>	<u>OLS Estimate</u>	<u>Annual</u> <u>Growth</u>	<u>OLS vs.</u> <u>Executive</u> <u>Difference</u>
Gross Income Tax	\$12,351.0	7.7%	\$12,124.0	7.7%	-\$227.0
Sales Tax	8,778.0	4.2%	8,723.0	4.2%	-55.0
Corporation Business Tax	2,342.0	-13.6%	2,342.0	-13.6%	0.0
Insurance Premiums Tax	503.0	3.1%	485.0	3.2%	-18.0
Realty Transfer Fee	380.0	-4.0%	370.0	-3.9%	-10.0
Corp. Tax on Banks and Fin.	100.0	0.0%	90.0	0.0%	-10.0
Cigarette Tax	252.0	10.5%	246.0	10.3%	-6.0
Other Revenues	7,246.1	3.4%	7,246.1	3.4%	0.0
Grand Total, All Funds	\$31,952.1	3.7%	\$31,626.1	3.6%	-\$326.0

See Appendix for additional detail. Numbers may not add due to rounding.

Figure 4 displays the Executive FY 2008 revenue estimates as presented in the Governor's Budget Recommendation and the OLS forecast. Highlights of the revenue estimates include:

FY 2008 Executive:

- The Executive expects total revenues to grow by \$1.1 billion, or 3.7% over FY 2007.
- The Executive estimate for the income tax is up \$886 million, or 7.7% over FY 2007.
- The Executive estimate for the sales tax is up \$353 million, or 4.2% over FY 2007.
- The Executive estimate for the corporation business tax is down \$368 million, or 13.6% from FY 2007.
- The Executive estimates for four other major taxes are up by a combined \$23 million.
- The Executive estimates for all other revenues are up by a combined \$235 million.

FY 2008 Office of Legislative Services:

- The OLS total revenue estimates for FY 2008 are **\$326 million below** the Executive's projection.
- The OLS estimate for the income tax is \$227 million below the Executive's.
- The OLS estimate for the sales tax is \$55 million below the Executive's.
- The OLS estimate for the corporation business tax is the same as the Executive's.
- The OLS estimates for the four other major taxes are \$44 million below the Executive's.
- The OLS estimates for all other revenues are the same as the Executive's.

Budgetary Impact of OLS Revenue Estimates

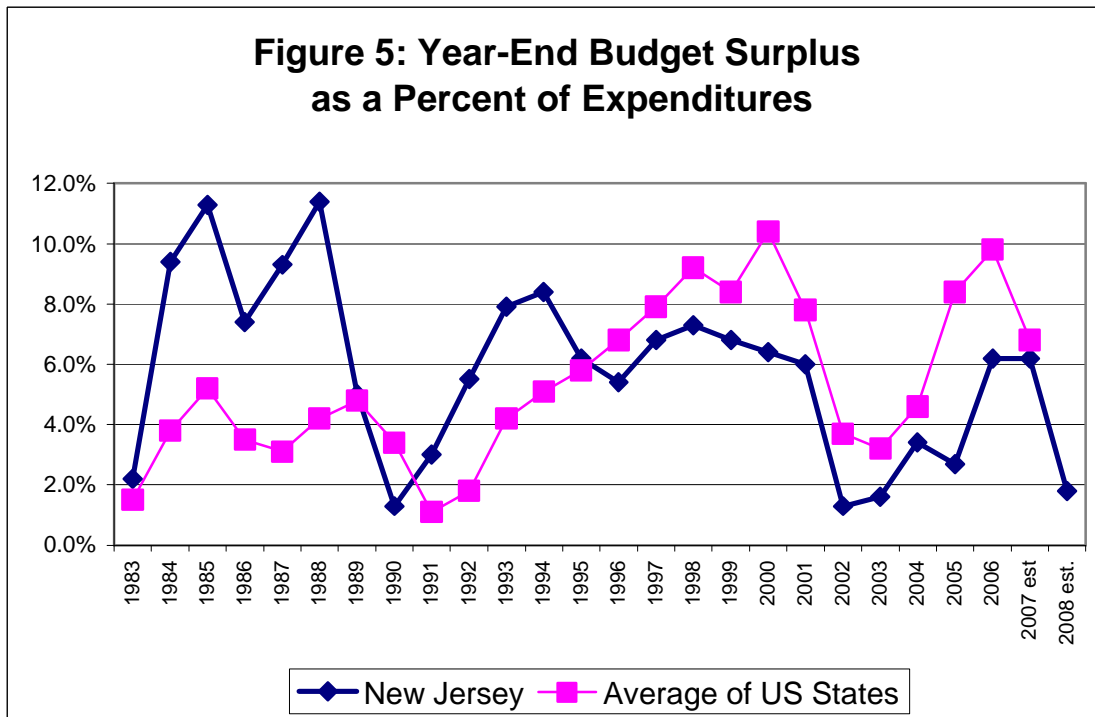
Combined over the two year period, the OLS revenue estimates are \$625 million less than the Executive's -- \$299 million less in FY 2007 and \$326 million less in FY 2008.

The Executive projects an FY 2008 year-end balance of \$601 million, or about 1.8% of budgeted expenditures. As part of its annual analysis, the OLS recalculates the State's year-end budgeted balance based solely on the revenue forecast differences between the Executive and the OLS. **All other things being equal, the lower OLS revenue estimates would produce a year-end deficit of \$24 million.** Since the State is prohibited from budgeting a deficit, the Legislature would have to change the appropriations bill to restore a positive balance, if the OLS revenue estimates are correct.

The Executive's *projection* of a 1.8% surplus is low by historical standards for New Jersey. As is shown in Figure 5, over the last quarter

century the State's *actual* surplus has exceeded 2% of expenditures in almost every year except during economic recessions (1983, 1990, and 2002). The national average of all states' surpluses has exceeded New Jersey's level every year since FY1996, based on survey data compiled by the National Association of State Budget Officers. The Executive's low projected surplus leaves the State budget vulnerable if revenues fall short, as in the OLS estimates presented in this report.

This surplus calculation assumes that the spending plan and tax law changes in the FY 2008 Executive budget will be followed. The actual balance will be determined by numerous spending decisions as well as revenue collections. Decisions on these and other matters will be made by the Executive, both budget committees and the full Legislature during the next three months and throughout the fiscal year.



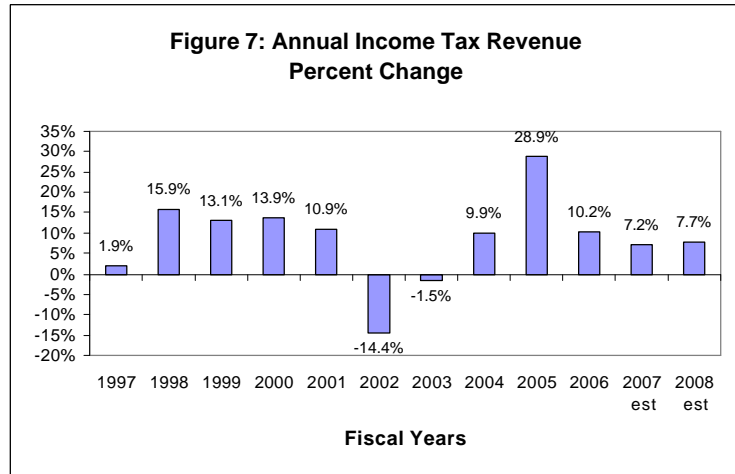
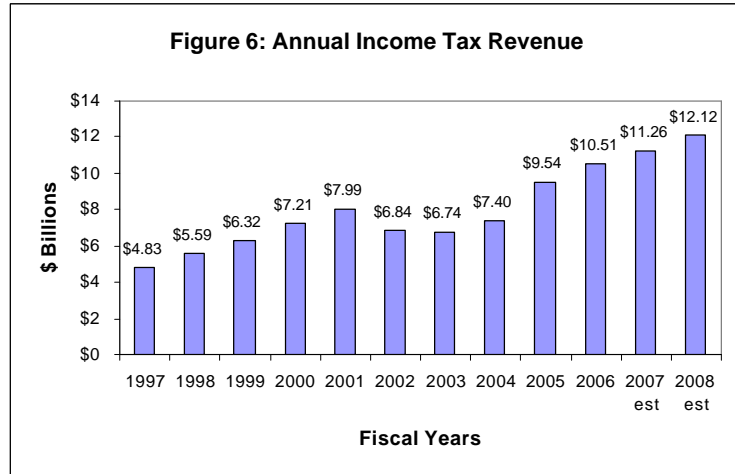
Discussion of the Gross Income Tax

The most significant revenue difference between the Executive and the OLS lies with the gross income tax (GIT). The OLS is projecting \$205 million less in FY2007 and \$227 million less in FY2008, accounting for a combined \$432 million of the total \$625 million revenue difference.

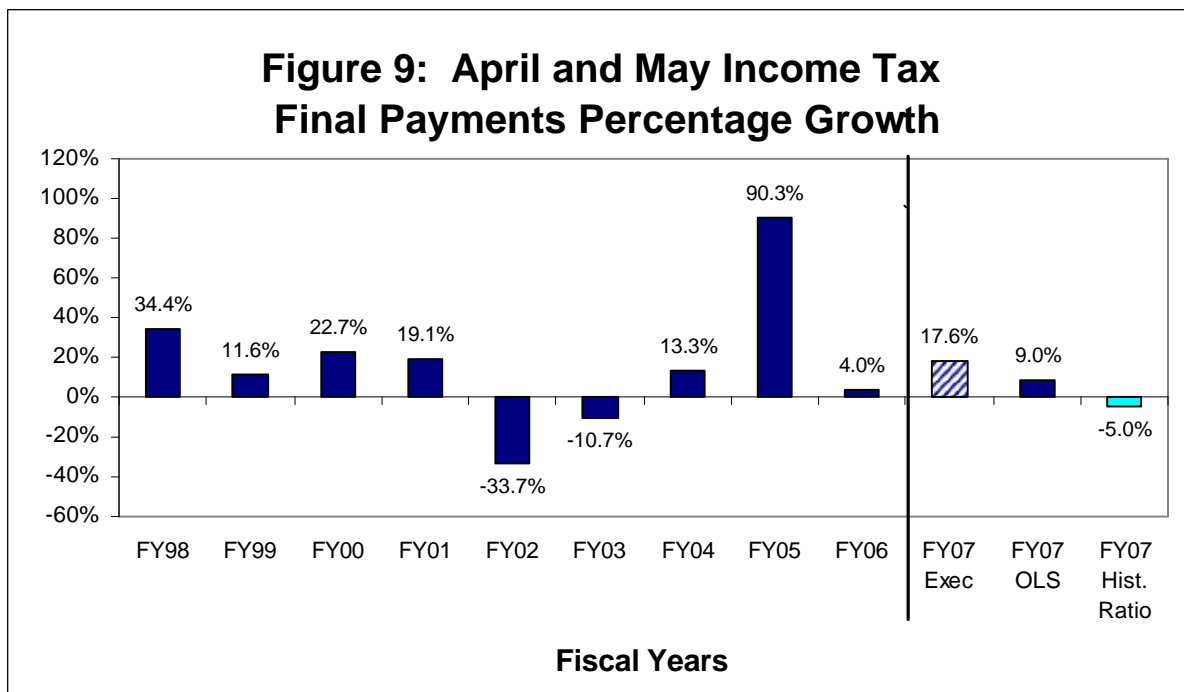
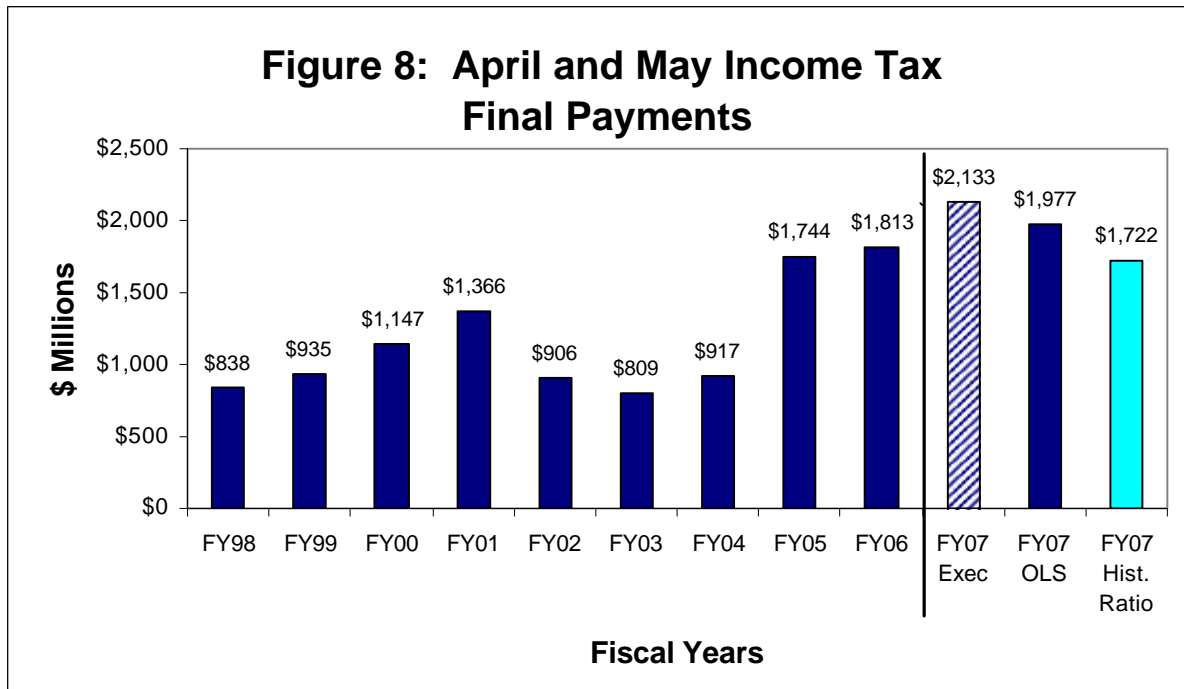
Yet, this \$432 million difference equals less than 2% of the Executive's GIT estimates. Because the GIT is New Jersey's largest State tax revenue, even a relatively minor statistical difference in estimates produces a significant dollar difference.

The GIT is also a particularly volatile revenue source. Figure 6 and Figure 7 display that volatility, with double-digit rates of growth during the late 1990's followed by the unprecedented declines in FY2002 and FY2003. This volatility is due to the increasing importance of high-income taxpayers. The top 1% of filers, those with incomes over \$500,000, pay 40% of the GIT. Filers with income over \$100,000 pay over 80% of the tax. These high-income taxpayers get substantial income from volatile, non-wage sources such as capital gains, business income and partnerships.

Through the end of February, the GIT is up only 6.7% over the same period last year, below the Executive's target growth of 9.1% for FY2007 (Figure 2, page 3). The OLS is taking a more cautious view of the GIT, due to the relative weakness of certain tax payments from high-income filers and the timing of pending additional payments.



High income individuals pay much of their liabilities through **quarterly estimated payments** and through **final payments in April**. Estimated payments are up by only 6.3% so far in FY2007, and up by only 7.3% for all of Tax Year 2006. As discussed further on the following pages, estimated payments are an important leading indicator for the April final payments. These final payments alone will total about \$2 billion in the spring. To put that in perspective, if GIT final payments were a distinct tax, it would be the State's fourth largest revenue, just behind the corporation business tax.



April Final Payments Hard to Predict

Figure 8 shows that the Executive is estimating \$2.133 billion from the April/May final payments, while the OLS is estimating \$1.977 billion, a \$156 million difference that accounts for three-quarters of the GIT forecasting variance. The Executive forecasts growth of 17.6% from last spring, shown in **Figure 9**, while the OLS is estimating 9.0% growth. The figures also show a third scenario in which final payments decline by 5% to only \$1.722 billion.

Unlike withholding from wages, which comes in weekly or biweekly and provides useful trends to track and analyze, the final payments effectively come in all at once. As **Figure 9** also shows, the final payments can swing wildly from year-to-year. Accordingly, tax analysts must consult other data to forecast this revenue. Historically, the best indicator for final payments has been the quarterly estimated payments, particularly the fourth estimated payment that is received in December and January.

Estimated payment growth averaged 9% for the first three quarters of Tax Year 2006, but slipped unexpectedly to only 5% growth during the last, largest payment in December/January (about \$1.05 billion total). Historically, a soft December/January estimated payment has signaled soft growth in April/May final payments.

The Treasurer's staff assumes that the estimated payments, and particularly the fourth payment, were depressed artificially because taxpayers had an unusually high level of credits from the prior year that were applied against tax liabilities. Accordingly, the soft January payments may not be a good indicator of April/May final payments this year. Treasury's estimate for strong 17.6% growth in final payments requires that April/May final payments *double* the December/January estimated payments. The only time in the last decade that spring final payments doubled the winter estimated

payment was in FY 2005 – an atypical year in which the implementation of a new tax bracket on high income taxpayers disrupted the normal pattern of payments.

An alternative forecasting approach would assume that the correlation between December/January estimated payments and April/May final payments returns to the historic pattern seen prior to FY 2005. Such a calculation suggests that final payments would *decline* by 5%, yielding only \$1.722 billion -- \$255 million below the OLS target. At this time, the OLS does not see an underlying economic explanation for a drop in final payments suggested by the purely mathematical application of historic ratios.* Instead, the OLS assumes that the mathematical relationship between estimated payments and final payments will be similar to last year, yielding 9.0% growth to \$1.977 billion in revenue.

FY2008 Depends on FY2007 Outcome

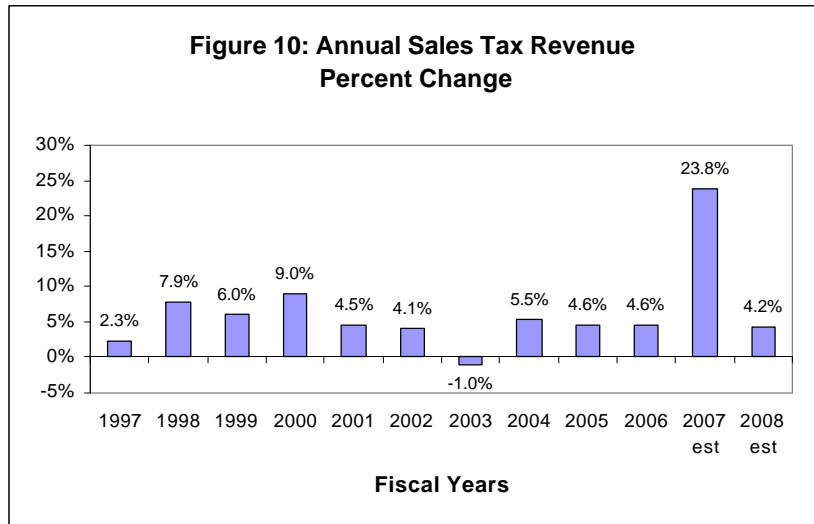
The OLS and the Executive generally agree on a modest growth rate for the GIT going into FY2008. The Executive forecasts 7.7% growth to \$12.351 billion, while the OLS forecasts 7.7% growth to \$12.124 billion. The \$227 million difference is largely a function of the OLS's lower base for FY2007. Indeed, most of the FY2008 difference should be resolved once the results of the FY2007 April/May final payment receipts are reported in the middle of May.

The Executive's FY2008 GIT estimate includes a \$64 million reduction for a proposed expansion of the New Jersey earned income credit. For the purposes of this report, the OLS assumes this policy change will be implemented. However, the OLS estimates a smaller revenue loss of \$36 million, discussed in detail in the appendix.

* The California Legislative Analyst's Office is projecting a decline in that state's final payments.

Discussion of Other Selected Revenues

Sales Tax: Following the rate increase and tax base expansion enacted in July of 2006, sales tax revenue is expected to increase significantly in FY2007, accounting for about 27% of State budgeted revenues, second only to the gross income tax. Modest underlying growth is expected to be boosted by approximately \$1.5 billion from the tax changes, netting overall growth of nearly 24%. Modest base growth of about 4% is expected for FY2008. **Figure 10** displays



current growth expectations for this year and next year, and shows historical growth rates for the prior decade.

The OLS's revenue estimate of \$8.375 billion is \$50 million below the Executive's estimate for FY2007*. The OLS's \$8.723 billion estimate for FY2008 is \$55 million lower than the Executive's forecast. The growth rate through the end of February is only 20.5%, which means that reaching the Executive's year-end target will require 30% growth over the final months of the fiscal year. February was the only month this year to match or exceed 30% growth, with other months falling short. Accordingly, the OLS is taking a cautious view in estimating \$50 million less in the current year. The OLS accepts the Executive's growth estimates for FY2008, but the lower FY2007 base rolls forward into the lower OLS total for next year.

Corporation Business Taxes: The corporation business tax (CBT) is the State budget's third largest revenue, accounting for about 9% of total on-budget revenues. The Executive is projecting \$2.710 billion in

FY2007 and a decline to \$2.342 billion in FY2008*. The OLS does not have strong evidence to dispute Executive estimates that fall within a reasonable range. Through the end of February, CBT collections are down 7% from the same time last year, below the Executive's target rate of a 4.5% decline. However, quarterly payments have matched or exceeded expectations and the payments for April and June are still pending, providing confidence that the year-end target is achievable.

CBT receipts are expected to decline by 13% in FY2008, as profits slow, the alternative minimum assessment expires (-\$160 million), and net operating loss deductibility is fully phased in (-\$80 million). The Executive also estimates that the scheduled statutory elimination of the 0.67% tax rate on S-corporations will reduce revenues by \$35 million.

The OLS is estimating \$10 million less each year for the smaller **CBT on banks and financial institutions**. The Executive is estimating \$100 million total each year, but based on an overall decline of 39% so far in FY2007, and a particularly sharp drop in December, the OLS is estimating \$90 million in both FY2007 and FY2008.

* Sales tax and CBT figures exclude amounts from energy tax collections (see pages A-2 to A-6).

Insurance Premiums Tax: The OLS is projecting \$18 million less than the Executive in both fiscal years for the insurance premiums tax. This lower estimate is based on initial data from the March 1 payment date and preliminary figures for receipts in March. This tax is paid primarily in two payments each year, on March 1 and on June 1. The Executive's February estimate of \$488 million in FY2007 anticipated a 5% decline. Preliminary figures from March receipts indicate that gross collections may be down by about 10%. Accordingly, the OLS has reduced the estimate for FY2007 to \$470 million, \$18 million below the Executive's figure. The OLS makes the same downward adjustment for FY2008, rolling the FY2007 difference forward.

Realty Transfer Fee: The OLS is projecting \$11 million less in FY2007 and \$10 million less in FY2008 for the realty transfer fee than is the Executive. This has not been a good year for home sales, and the current trend in this tax's collections is similarly weak. Through the end of February, collections are down 20%, compared to the Executive's forecast of a 14% decline for FY2007. Accordingly, the OLS has reduced its estimate and rolled that reduction forward into the FY2008 estimate.

Cigarette Tax: The cigarette tax has become analytically more complex as larger portions of the tax have been dedicated for off-budget purposes. Details of the funding allocations and the Executive and OLS estimates are shown in **Figure 11** below. \$370 million is transferred to the Health Care Subsidy Fund to support charity care costs at New Jersey hospitals. Additional amounts that vary annually are dedicated to support debt service payments on the cigarette tax revenue bonds.

In February, the Executive increased its total estimate for FY2007 to \$800 million, \$5 million over the amount certified in the Appropriations Act last summer. However, even with the 17.5 cents per pack rate increase, collections through the end of February are down nearly 1% from the same period last year. Accordingly, the OLS is holding to the certified amount of \$795 million, \$5 million below the Executive's revised estimate.

The OLS agrees with the Executive's projection of a decline for FY2008, as cigarette sales have tended to fall over time. The OLS's slightly lower FY2007 base rolls forward into an estimate of \$6 million less than the Executive for FY2008.

Figure 11: Cigarette Tax Estimates and Distributions

Millions of Dollars

	<u>Actual FY2006</u>	<u>Approp. Act FY2007</u>	<u>Executive Estimates</u>		<u>OLS Estimates</u>		<u>OLS Difference</u>	
			<u>FY2007</u>	<u>FY2008</u>	<u>FY2007</u>	<u>FY2008</u>	<u>FY2007</u>	<u>FY2008</u>
Total Collections All Sources	\$787.6	\$795.2	\$800.0	\$776.0	\$795.0	\$770.0	-\$5.0	-\$6.0
Less, Health Care Subsidy Fund	-155.0	-370.0	-370.0	-370.0	-370.0	-370.0	0.0	0.0
Less, Dedication for Debt Service	0.0	-210.2	-201.9	-195.9	-201.9	-195.9	0.0	0.0
Plus, Unused Debt Service	0.0	0.0	0.0 *	41.9	0.0 *	41.9	0.0	0.0
Total Collections On-Budget	\$632.6	\$215.0	\$228.1	\$252.0	\$223.1	\$246.0	-\$5.0	-\$6.0

* \$43.22 million in FY2007 unused debt service funds appear as a Treasury revenue in FY2008 Schedule 1.

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Detailed Fiscal Year 2007 Revenue Estimates				
<i>Millions of \$</i>				
<u>Revenue Source</u>	<u>Appropriations Act (July 2006)</u>	<u>Executive Revised</u>	<u>OLS</u>	<u>Diff: OLS - Executive</u>
Major Taxes:				
Sales Tax, Total	\$8,721.6	\$8,767.5	\$8,717.5	-\$50.0
<i>Sales Tax, Base</i>	8,483.6	8,425.0	8,375.0	-50.0
<i>Sales Tax, Energy</i>	238.0	342.5	342.5	0.0
Corporation Business Tax, Total	\$2,607.1	\$2,798.2	\$2,798.2	\$0.0
<i>Corporation Business Tax, Base</i>	2,478.6	2,710.0	2,710.0	0.0
<i>Corporation Business Tax, Energy</i>	128.5	88.2	88.2	0.0
Inheritance Taxes	600.0	602.0	602.0	0.0
Motor Fuels	553.0	566.0	566.0	0.0
Insurance Premiums	495.0	488.0	470.0	-18.0
Realty Transfer Fee	415.0	396.0	385.0	-11.0
Motor Vehicle Fees	275.2	295.2	295.2	0.0
Cigarette	215.0	228.1	223.1	-5.0
Petroleum Products Gross Receipts	225.0	231.0	231.0	0.0
Corporation Business - Banks and Financial	120.0	100.0	90.0	-10.0
Alcoholic Beverage Excise	94.0	92.0	92.0	0.0
Tobacco Products Wholesale	16.0	14.0	14.0	0.0
Public Utilities Excise	10.9	10.9	10.9	0.0
Subtotal, Major Taxes	\$14,347.9	\$14,589.0	\$14,495.0	-\$94.0
Misc. Taxes, Fees and Revenues				
Assessment on Homes Sold Over \$1 Million	113.0	150.0	150.0	0.0
Transitional Energy Facility Assessment	250.9	221.7	221.7	0.0
Public Utility Taxes (State Retention)	75.0	82.2	82.2	0.0
Medicaid Uncomp. Care Reimbursement	349.8	368.9	368.9	0.0
Telephone Assessment	119.0	124.0	124.0	0.0
Hotel Occupancy Tax	78.9	78.9	78.9	0.0
Interdepartmental Accounts	583.8	573.6	573.6	0.0
Other	1,206.0	1,183.5	1,183.5	0.0
Subtotal, Misc. Revenues	\$2,776.4	\$2,782.8	\$2,782.8	\$0.0
Interfund Transfers				
State Lottery Fund	846.0	812.7	812.7	0.0
Unclaimed Personal Property Trust Fund	311.3	311.3	311.3	0.0
Tobacco Settlement/Securitization	27.3	14.7	14.7	0.0
Other	299.8	312.9	312.9	0.0
Subtotal, Interfund Transfers	\$1,484.4	\$1,451.7	\$1,451.7	\$0.0
TOTAL GENERAL FUND	\$18,608.6	\$18,823.4	\$18,729.4	-\$94.0
Property Tax Relief Fund (Income Tax), Total	\$11,475.0	\$11,465.0	\$11,260.0	-\$205.0
Casino Revenue Fund	\$468.1	\$458.0	\$458.0	\$0.0
Casino Control Fund	\$72.0	\$75.7	\$75.7	\$0.0
Gubernatorial Elections Fund	\$0.7	\$0.7	\$0.7	\$0.0
GRAND TOTAL, ALL FUNDS	\$30,624.5	\$30,822.8	\$30,523.8	-\$299.0

Detailed Fiscal Year 2008 Revenue Estimates					
<i>Millions of \$</i>					
<u>Revenue Source</u>	<u>February 2007 Gov's Budget</u>	<u>GBM % Change</u>	<u>March 2007 OLS Original</u>	<u>OLS % Change</u>	<u>Diff: OLS - Executive</u>
Major Taxes:					
Sales Tax, Total	\$9,188.2	4.8%	\$9,133.2	4.8%	-\$55.0
<i>Sales Tax, Base</i>	8,778.0	4.2%	8,723.0	4.2%	-55.0
<i>Sales Tax, Energy</i>	410.2	19.8%	410.2	19.8%	0.0
Corporation Business Tax, Total	\$2,433.7	-13.0%	\$2,433.7	-13.0%	\$0.0
<i>Corporation Business Tax, Base</i>	2,342.0	-13.6%	2,342.0	-13.6%	0.0
<i>Corporation Business Tax, Energy</i>	91.7	4.0%	91.7	4.0%	0.0
Inheritance Taxes	602.0	0.0%	602.0	0.0%	0.0
Motor Fuels	580.0	2.5%	580.0	2.5%	0.0
Insurance Premiums	503.0	3.1%	485.0	3.2%	-18.0
Realty Transfer Fee	380.0	-4.0%	370.0	-3.9%	-10.0
Motor Vehicle Fees	278.4	-5.7%	278.4	-5.7%	0.0
Cigarette	252.0	10.5%	246.0	10.3%	-6.0
Petroleum Products Gross Receipts	237.0	2.6%	237.0	2.6%	0.0
Corporation Business - Banks and Financial	100.0	0.0%	90.0	0.0%	-10.0
Alcoholic Beverage Excise	94.0	2.2%	94.0	2.2%	0.0
Tobacco Products Wholesale	14.0	0.0%	14.0	0.0%	0.0
Public Utilities Excise	10.9	0.0%	10.9	0.0%	0.0
Subtotal, Major Taxes	\$14,673.3	0.6%	\$14,574.3	0.5%	-\$99.0
Misc. Taxes, Fees and Revenues					
Assessment on Homes Sold Over \$1 Million	157.0	4.7%	157.0	4.7%	0.0
Transitional Energy Facility Assessment	234.2	5.6%	234.2	5.6%	0.0
Public Utility Taxes (State Retention)	82.2	0.0%	82.2	0.0%	0.0
Medicaid Uncomp. Care Reimbursement	464.8	26.0%	464.8	26.0%	0.0
Telephone Assessment	124.0	0.0%	124.0	0.0%	0.0
Hotel Occupancy Tax	79.0	0.1%	79.0	0.1%	0.0
Interdepartmental Accounts	608.8	6.1%	608.8	6.1%	0.0
Other	1,161.7	-1.8%	1,161.7	-1.8%	0.0
Subtotal, Misc. Revenues	\$2,911.7	4.6%	\$2,911.7	4.6%	\$0.0
Interfund Transfers					
State Lottery Fund	848.0	4.3%	848.0	4.3%	0.0
Unclaimed Personal Property Trust Fund	183.6	-41.0%	183.6	-41.0%	0.0
Tobacco Settlement/Securitization	108.6	636.5%	108.6	636.5%	0.0
Other	348.1	11.2%	348.1	11.2%	0.0
Subtotal, Interfund Transfers	\$1,488.3	2.5%	\$1,488.3	2.5%	\$0.0
TOTAL GENERAL FUND	\$19,073.2	1.3%	\$18,974.2	1.3%	-\$99.0
Property Tax Relief Fund (Income Tax), Total	\$12,351.0	7.7%	\$12,124.0	7.7%	-\$227.0
Casino Revenue Fund	\$453.1	-1.1%	\$453.1	-1.1%	\$0.0
Casino Control Fund	\$74.0	-2.2%	\$74.0	-2.2%	\$0.0
Gubernatorial Elections Fund	\$0.7	0.0%	\$0.7	0.0%	\$0.0
GRAND TOTAL, ALL FUNDS	\$31,952.1	3.7%	\$31,626.1	3.6%	-\$326.0

Revenues from Taxes on Energy Providers

Energy utilities are subject to the sales and use tax, the corporation business tax (CBT) and the transitional energy facility assessment (TEFA), a tax intended to phase out over time. Telecommunications utilities are subject to the CBT. The revenues are divided into two categories: **municipal use**, which are "off budget" and **State use**, which are "on budget."

Figure A displays public utility revenues between FY 1991 and FY 2008. Collections through FY 1997 were under the old public utility tax system. The State use portions from FY 1992 to FY 1994 included substantial statutory prepayments from large utilities. Since FY 1998, taxes have been collected under the current law. Figures B through D display the actual and anticipated revenues between FY 2006 and FY 2008 in greater detail.

From a budgeting perspective, the municipal use tax revenues are credited to the Energy Tax Receipts Property Tax Relief Fund (ETR Fund), and allocated to municipalities under a statutory formula. These amounts, considered "off budget," are not included in either the anticipated Schedule 1 revenues or

the amount of State aid appropriated in the annual appropriations act. This amount has stabilized at \$788.5 million annually since FY 2005.

After allocating \$788.5 million to the ETR Fund, the remaining revenues come "on budget" for use in the State General Fund. Some of this on budget portion is the TEFA, which was originally scheduled to end in FY 2002. However, P.L.2006, c.40, extended the TEFA payments through FY 2010. The Executive is estimating TEFA payments of \$221.6 million in FY 2007 and \$234.2 million in FY 2008.

The portion of energy revenue from the CBT and the sales tax not needed for the ETR Fund has grown significantly, rising from \$72.2 million in FY 2005 to an expected \$502.1 million by FY 2008. Economic growth and the recent sales tax rate increase have contributed to this rise. Total "on budget" collections from energy and utility sources are estimated at \$745.4 million in FY 2007 and \$829.2 million in FY 2008, up from \$400.2 million in FY 2005.

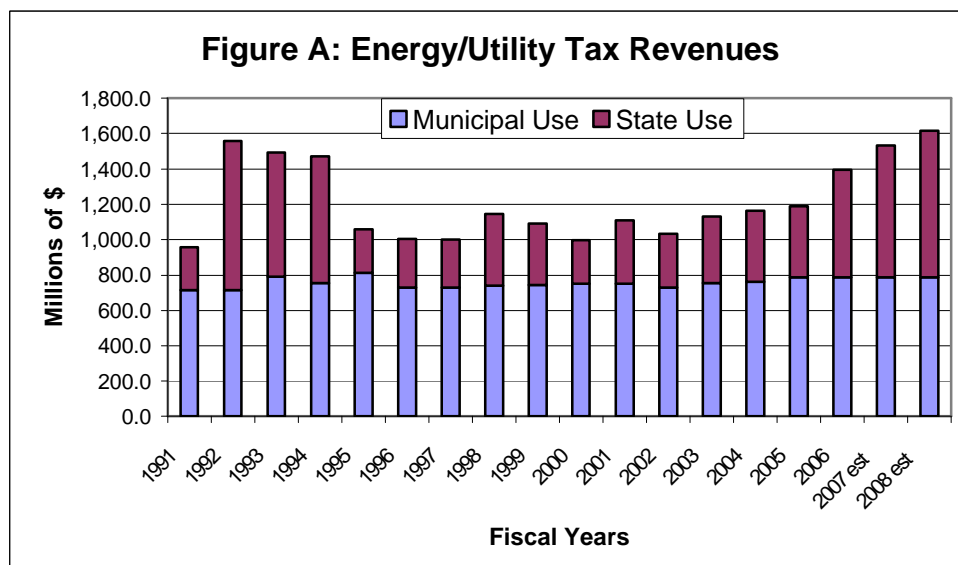


Figure B
Actual Energy/Utility Tax Revenue Fiscal Year 2006
Millions of \$

<u>Revenue Source</u>	<u>On-Budget (State Use)</u>	<u>Off-Budget (Municipal Use)</u>	<u>Total</u>
Sales and Use Tax	\$87.4	\$788.5	\$875.9
Corporation Business Tax	\$169.9		\$169.9
Transitional Energy Facilities Assessment (TEFA)	\$254.0		\$254.0
Customer Specific Tax	\$0.4		\$0.4
Franchise and Gross Receipts Tax			
Water and Sewer Utilities	\$82.2		\$82.2
Public Utility Excise Tax Water and Sewer Utilities	\$10.9		\$10.9
Total	\$604.8	\$788.5	\$1,393.3

Source: Department of Treasury, March 2007.

Figure C
Anticipated Energy/Utility Tax Revenue Fiscal Year 2007
Millions of \$

<u>Revenue Source</u>	<u>On-Budget (State Use)</u>	<u>Off-Budget (Municipal Use)</u>	<u>Total</u>
Sales and Use Tax	\$342.5	\$699.1	\$1,041.6
Corporation Business Tax	\$88.2	\$89.4	\$177.6
Transitional Energy Facilities Assessment (TEFA)	\$221.6		\$221.6
Customer Specific Tax			
Franchise and Gross Receipts Tax			
Water and Sewer Utilities	\$82.2		\$82.2
Public Utility Excise Tax Water and Sewer Utilities	\$10.9		\$10.9
Total	\$745.4	\$788.5	\$1,533.9

Source: Department of Treasury, March 2007.

Figure D			
Anticipated Energy/Utility Tax Revenue Fiscal Year 2008			
<i>Millions of \$</i>			
Revenue Source	<u>On-Budget</u> <u>(State Use)</u>	<u>Off-Budget</u> <u>(Municipal Use)</u>	Total
Sales and Use Tax	\$410.2	\$699.1	\$1,109.3
Corporation Business Tax	\$91.7	\$89.4	\$181.1
Transitional Energy Facilities Assessment (TEFA)	\$234.2		\$234.2
Customer Specific Tax			\$0.0
Franchise and Gross Receipts Tax			
Water and Sewer Utilities	\$82.2		\$82.2
Public Utility Excise Tax Water and Sewer Utilities	\$10.9		\$10.9
Total	\$829.2	\$788.5	\$1,617.7

Source: Department of Treasury, March 2007.

Proposed Expansion of the NJ Earned Income Credit Program

The Governor's FY2008 Budget Recommendation proposes an expansion of the State Earned Income Credit (EIC) program. Established pursuant to P.L.2000, c.80 (C.54A:4-6 et seq.), the State EIC, like the federal earned income tax credit program (EITC) on which it piggybacks, is intended to "make work pay" for low- and moderate-wage earners by offsetting the burden of Social Security payroll taxes, supplementing earnings and complementing efforts that help families transition from welfare to work.*

The Governor's proposal would expand eligibility under the existing State credit program to include all taxpayers eligible to participate in the federal EITC. Currently, taxpayers who are eligible for the federal EITC, but who do not have dependent children are not eligible under the State program. Moreover, although federal program benefits phase out at an income threshold of \$38,348 for taxpayers with two or more children (an amount which is adjusted annually for inflation), the current State EIC** has had a fixed eligibility

threshold of \$20,000 since inception. New Jersey's program is the only State EIC program to impose an income eligibility ceiling below federal program limits. That lower income threshold and the exclusion of people without dependent children eliminates about one-half of *federally* qualified beneficiaries (See **Figure B**).

In addition to expanding the program to include all federal eligibles, the Governor's budget also proposes to increase, on a phased-in basis over three years, the State benefit amount to 25% of the federal benefit by Tax Year (TY) 2010. (See projected benefit amounts in **Figure A**). Currently, the State EIC provides a refundable earned income tax credit under the New Jersey gross income tax equal to 20 percent of the federal EITC. The current percentage match was phased in over a four year period: 10% in TY2000; 15% in TY2001; 17.5% in TY2002; and 20% in TY2003.

According to the Center on Budget and Policy Priorities, as of 2006, New Jersey was one of 20 states, including the District of Columbia, with an EIC program.

* "A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty in 2006," Center for Budget and Policy Priorities, March 2006.

** At the time the EIC was created, the rationale for the \$20,000 income limit was related to the State's anticipated ability to utilize federal Temporary Assistance for Needy Families (TANF) dollars to offset program costs. Under federal TANF rules established pursuant to the Welfare Reform Law of 1996, it is permissible to finance the refundable portion of EIC with TANF dollars, or with the "maintenance of effort" (MOE) funds states are required to spend to access federal TANF monies. Also under federal rules, a taxpayer who receives a refundable credit need not be a welfare recipient or meet the State's welfare eligibility requirements for this provision to hold, since federal law only requires TANF and

MOE funds be spent on "needy" families, a definition determined by the State. Subsequently, as indicated in "Figure C" of this Appendix, in the first years of the EIC, TANF covered most program costs. However, since FY2005, the amount of federal TANF dollars allocated by the State for this purpose has been reduced to approximately \$18 million annually.

Figure A: Estimated Earned Income Credit Amounts				
Federal Credit Amounts by Family Income *		Proposed State EIC Based on Inflation Adjusted Federal Credit**		
Married or Single w/2 or + Children	Federal Credit TY2006	FY2008 (20.0%)	FY2009 (22.5%)	FY2010 (25.0%)
\$10,000	\$3,990	\$819	\$945	\$1,077
\$15,000	\$4,536	\$931	\$1,074	\$1,225
\$20,000	\$3,869	\$794	\$916	\$1,045
\$25,000	\$2,816	\$578	\$667	\$760
\$30,000	\$1,763	\$362	\$418	\$476
\$35,000	\$710	\$146	\$168	\$192
\$38,000	\$79	\$16	\$19	\$21
Married or Single Filer w/1 Child				
\$10,000	\$2,747	\$564	\$651	\$742
\$15,000	\$2,747	\$564	\$651	\$742
\$20,000	\$2,241	\$460	\$531	\$605
\$25,000	\$1,442	\$296	\$342	\$389
\$30,000	\$643	\$132	\$152	\$174
\$34,000	\$4	\$1	\$1	\$1
Married Filer, No Dependents				
\$10,000	\$317	\$65	\$75	\$86
Single Filer, No Dependents				
\$10,000	\$164	\$34	\$39	\$44

Notes:

Shaded benefit amounts reflect new participant categories under expanded State program.

* For TY2006, the Federal EITC phases out at: \$34,000 for married and single filers with one child; \$38,348 for married and single filers with two or more children; \$12,000 for single filers with no children; and \$14,100 for married filers with no children.

** The Federal credit is adjusted annually for inflation. The projections above assume an annual inflation rate of 2.6% through FY2010.

According to the Budget in Brief, the Governor's FY2008 Budget includes \$64 million for the incremental cost of these proposed EIC enhancements. Total program costs are expected to rise from an estimated \$123 million in the current fiscal year (for TY2006) to \$185 million in FY2008. The Executive projects that the incremental cost will increase to \$91 million in FY2009 (for TY2008) and \$118 million in FY2010 (for

TY2009) as the State benefit increases to 22.5% and 25%, respectively, of the federal credit amounts. The Executive further assumes that participation by New Jerseyans in the federal program will grow at a (roughly historical) rate of three percent annually and that 100 percent of all those who participate in the federal program will also participate in the State program.

Figure B: State EIC Participation Rates					
	A	B	C	D	E
	Number of NJ Taxpayers Participating in Federal EITC*	Number of NJ Federal EITC Participants* <\$20,000	Number from Column B Eligible for State EIC** (Estimated)	Number of State EIC Participants* (Actual)	Estimated Participation Rate for State EIC Program
TY2001	452,848	329,540	<i>250,450</i>	198,700	79.34%
TY2002	486,811	338,255	<i>257,074</i>	218,400	84.96%
TY2003	495,578	<i>346,905</i>	<i>263,647</i>	217,400	82.46%
TY2004	496,813	<i>347,769</i>	<i>264,305</i>	212,654	80.46%
TY2005	N/A to date	N/A	N/A	204,190	

Sources and Notes: Actual numbers appear in regular font, *estimates are italicized and shaded*.
 * Federal data from IRS Statistics of Income publications. State data (Column "D") is from N.J. Department of the Treasury Statistics of Income publications, or as reported by Treasury to OLS.
 ** Column "C" excludes those single and married taxpayers in Column "B" who do not have dependent children. Figures in Column "C" are estimated based on 2005 U.S. Census data (American Community Survey series) which indicate that approximately 76% of families living in poverty in New Jersey have dependent children.

The Office of Legislative Services (OLS) concurs in part with the Executive's assessment of future program costs, and emphasizes, as does the Executive, that actual costs will be largely driven by federal program growth and program participation rates. However, the OLS does not anticipate full (100%) participation, and as a result projects incremental program costs below those estimated by the Executive.

In no year since inception of the EIC have individuals who are federal participants, and who meet New Jersey's income and dependent requirements, equaled full participation in the State program (see **Figure B**). While it is reasonable to assume an increase in participation rates over time, no state with an earned income credit program has reported 100% participation. In fact, data published by the Center for Budget and Policy Priorities indicate that other states are

experiencing participation rates consistent with New Jersey's experience thus far.*

Utilizing a participation rate of 85%, the OLS projects marginal program costs of approximately \$36 million for FY2008, \$28 million less than the Executive (see **Figure C on page A-10**). Similarly, the OLS anticipates that program costs could be as much as \$33 million and \$37 million less than anticipated by the Executive for FY2009 and FY2010, respectively, unless participation rates increase from current levels.

* According to the Center for Budget and Policy Priorities, the cost of state credit programs which piggyback on the federal EITC should be discounted by at least ten percent.

Figure C: Earned Income Credit Program Costs								
Benefit Amount to New Jersey Taxpayers from Federal Earned Income Tax Credit*								
Taxpayers by Income	<i>(Millions of \$)</i>							
	TY 2002 (Actual)	TY2003 (Actual)	TY2004 (Actual)	TY2005 (Est.)	TY2006 (Est.)	TY2007 (Est.)	TY2008 (Est.)	TY2009 (Est.)
All Taxpayers	\$811.7	\$838.2	\$858.0	\$883.7	\$910.3	\$937.6	\$965.7	\$994.7
Under \$20,000	\$637.8	\$653.8	\$669.2	\$689.3	\$710.0	\$731.3	\$753.2	\$775.8
Over \$20,000	\$173.9	\$184.4	\$188.8	\$194.4	\$200.3	\$206.3	\$212.5	\$218.8
Cost of State Earned Income Credit**								
	<i>(Millions of \$)</i>							
	State FY2003 (Actual)	State FY2004 (Actual)	State FY2005 (Actual)	State FY2006 (Actual)	State FY2007 (Est.)	State FY2008 (Est.)	State FY2009 (Est.)	State FY2010 (Est.)
State Benefit as % of Federal	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	22.5%	25.0%
Total Current Gross State EIC Expenditures	\$84.0	\$115.2	\$113.5	\$113.7	\$121.0	\$123.0	\$126.0	\$131.0
Enhanced EIC Gross Cost Projections					Executive	\$187.5	\$217.3	\$248.7
					OLS	\$159.4	\$184.7	\$211.4
TANF Offset Amount	\$70.0	\$86.0	\$18.4	\$18.4	\$18.4	\$18.4	\$18.4	\$18.4
Total Current Net State EIC Expenditures	\$14.0	\$29.2	\$95.1	\$95.3	\$102.6	\$104.6	\$107.6	\$112.6
Enhanced EIC Net Cost Projections					Executive	\$169.1	\$198.9	\$230.3
					OLS	\$141.0	\$166.3	\$193.0
Incremental Cost of Enhanced EIC					Executive	\$64.5	\$91.3	\$117.7
					OLS	\$36.4	\$58.7	\$80.4
					Difference	-\$28.1	-\$32.6	-\$37.3
Notes:								
* Actual data for 2002 - 2004 from federal Internal Revenue Service SOI publications. Data for subsequent years is projected assuming a 3 percent annual growth in the federal program.								
** OLS estimates for FY2008 - FY2010 assume an 85 percent program participation rate. Executive estimates for the same period assume 100 percent participation by federal eligibles.								
"All Taxpayers" includes single and married taxpayers, both with and without children.								

New Jersey Economic Review and Outlook for 2006

State of New Jersey
Council of Economic Advisors
February 2007

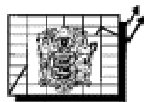
The Office of Legislative Services thanks the Council for permitting the reproduction of its annual economic report in the following appendix pages of the FY 2007-2008 Revenue Analysis.

NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2007

“Continued attention to economic development will add to New Jersey’s economic prospects in 2007.”

Joseph J. Seneca, Chairman

New Jersey Review and Forecast: Summary



The economic ledger for New Jersey has been closed on 2006 and a new one has opened for 2007. The state’s economic performance last year was strong in parts and tepid in others. In the current year, New Jersey will benefit from a strengthening national economy, but the state will need to continue to improve its long-run competitive position in order to keep pace with the nation in key areas of economic growth.

The recent changes in economic development policy in New Jersey are very encouraging and affirm the priority given by the Administration to economic growth. The elimination of two business taxes in fiscal year 2007 and the proposed elimination of another in fiscal year 2008 represent major investments to improve the business climate of the state. The reorganization of economic development policy under the Office of Economic Growth has already brought significant economic dividends to New Jersey with a coordinated approach to business retention and attraction. The stem cell initiative for the construction of capital facilities and the further allocation of stem cell research money is the first major strategic state investment in increasing science and technology research capacity in New Jersey since the 1980s. This sustained attention by the state to improving the business environment is exactly what is needed.

On the plus side last year, employment in New Jersey set a new record of 4,085,000 jobs as of December 2006. Total personal income grew by a solid 6.3% from the third quarter of 2005 to the same quarter in 2006, and nearly matched the U.S. increase of 6.7% despite the state’s slower population growth. Exports from New Jersey continued to boom, increasing by an amazing 28.1% over the prior year. This rapid growth in exports, along with continuing large increases in imports, especially in containerized cargo, has led to significant expansion in warehousing

and related trucking and transportation activity throughout the state.

Commercial real estate shows signs of stabilization and even improvement in some areas, as very high rents and low vacancy rates in Manhattan make New Jersey, once again, appealing as a relatively lower cost alternative for business expansion. Several highly visible business relocation decisions provide encouragement that the state can still be a player in the intensely competitive pharmaceutical and telecommunications industries. These include Verizon’s choice to locate and expand operations in the former AT&T site in Somerset County and Bayer Pharmaceuticals’ selection of New Jersey for its U.S. headquarters. However, both the pharmaceutical and telecommunications industries continue to experience profound structural changes as the effects of mergers and acquisitions, along with ever-intensifying competition, are amplified in New Jersey with its still large, but vulnerable, concentrations of research and headquarters operations.

Employment growth in the state improved in 2006 compared to a year earlier. Payroll jobs rose by 33,900 from December 2005 to December 2006. This was increase over the 22,800 jobs gained in 2005. However, the national growth rate in total employment of 1.7% in 2006 exceeded New Jersey’s increase of .8%. Bringing New Jersey’s employment growth closer to the national average is a worthy and important goal for economic development policy.

Job growth in New Jersey encouragingly accelerated in business and professional services in 2006 (13,500). There were also welcomed jobs gains in the information sector (2,200), a sector that has been under intense competitive pressure. Job losses occurred in manufacturing and trade, transportation, and utilities.

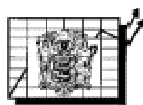
The state’s housing sector, following national trends, continued to unwind in 2006 with sharp declines in residential building permits and contract sales, along with large increases in unsold inventory. House price gains moderated significantly in 2006 and

NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2007

in some local markets, house values fell. While the rate of decline in the housing sector appears to have stabilized, it will be some time before housing resumes its previous role as an engine of economic growth, both in New Jersey and nationally.

Summary: New Jersey Forecast (% Change)		
	2006	2007
Gross State Product (Current \$, bill)	5.1	5.0
Personal Income (Current \$, bill)	6.1	5.7
Retail Sales (Current \$, bill)	4.9	5.0
Consumer Price Index (All Urban)	3.8	3.4
Total Non-Ag Employment	0.8	0.8

The U.S. Economy



The national economy ended 2006 with a lackluster fourth quarter when real Gross Domestic Product grew by 2.2 %. This increase represented the third straight quarter of below trend growth and was only a marginal improvement on the 2% growth rate of the third quarter. During the last three quarters of 2006, the slowdown in the housing sector, the impacts of a roller coaster ride of energy prices, and the cumulative effects of 17 consecutive quarter point increases in the federal funds rate brought GDP growth below 3%. For the year as a whole, real GDP rose by 3.3% due primarily to a strong first quarter growth of 5.6%.

Recent concerns that weakness in the housing sector would extend to the general economy have not, at least yet, been borne out. Consumer spending rose by 4.2% in the fourth quarter, energy prices retreated, and exports, supported by a weaker dollar and solid economic growth abroad, accelerated. All these private sector positive factors along with increased government spending contributed to growth in the fourth quarter. But inventory accumulation fell sharply and declines in both residential and non-residential investment accelerated.

Employment growth remained robust in 2006 and the Bureau of Labor Statistics benchmark revisions indicate that total employment grew by over 2.2 million jobs. Although this was lower than the 2.5 million jobs added in 2005, the nation has now gained over 2 million jobs annually for three consecutive years.

The outlook is for only modest growth in the national economy, although real GDP growth should increase as the year progresses. Growth will be supported by strong exports, solid consumer spending, and additional government outlays. The housing sector's drag on the economy will moderate from last year's estimated 1% point reduction in GDP growth. Employment growth should approach 2 million jobs. The Federal Reserve (FED) remains focused on inflation as strong job and wage gains, along with tepid productivity growth invoke inflation concerns. Inflation as measured by the Personal Consumption Expenditure index (2.8% in 2006) is above the desirable level stated by the FED, but did not, as of the end of 2006, shown any sign of accelerating. However, weakness in manufacturing and the fourth quarter decline in non-residential investment point to continuing tepid GDP growth well into 2007. Any decline in equity prices, if large and sustained, could also reduce consumer spending.

Employment Profile

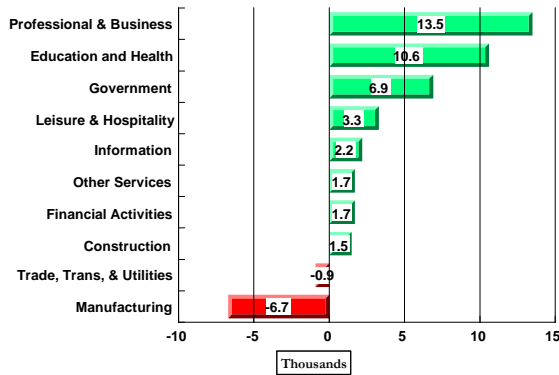


Following data revisions, payroll employment rose by 33,900 jobs in 2006. There were gains in the private service-producing sector (32,100 jobs), which were partially offset by a loss of 6,700 jobs in manufacturing (-2%). The state's manufacturing sector has now lost 101,300 jobs between December 2000 and December 2006, continuing a trend that began in 1969. Arresting this long-term decline remains a difficult, but important challenge. New Jersey still has over 320,000 manufacturing jobs.

The professional and business services sector had the largest gain in employment (13,500 jobs). Of particular note was the growth in employment in management of companies and enterprises, a sub-sector within professional and business services. Education and health services had the second largest increase in employment (10,600 jobs). Leisure and hospitality services added 3,300 jobs. The information sector, encouragingly, added 2,200 jobs after several years of losses. Financial services and other services each grew by 1,000 jobs. Employment fell by 900 jobs in trade, transportation and utilities. The government sector added 6,900 jobs.

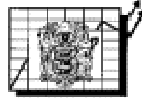
NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2007

NJ Employment Change (000) by Sector, 2005-06 (Seasonally Adjusted)



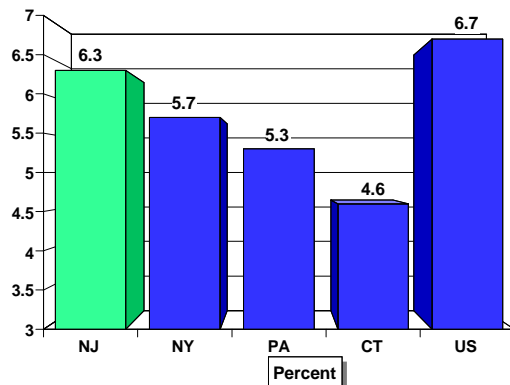
(Source: U.S. Bureau of Labor Statistics)

Personal Income and Consumer Spending



The state's median household income remains the highest in the nation (\$61,672) and the state has the highest population density in the nation. This combination represents a consumer market of unparalleled breadth and depth. Moreover, the state's recent gains in personal income, despite tepid job growth in 2006, have been strong. As of the third quarter of 2006, *total personal income* in New Jersey rose by 6.3% from a year earlier, very close to the U.S. growth rate of 6.7%. This is noteworthy given that population is growing slower in New Jersey compared to the nation. The strong year on Wall Street and record bonuses, along with solid salary and wage increases for the existing work force propelled the state's income growth rate. New Jersey's increase in total personal income exceeded that of all its neighboring states.

Percentage Change in Total Personal Income Q3 2005 - Q3 2006



An analysis of the components of the state's personal income indicates that wages and salaries make up 59.3% of the total, proprietors' income represents 8.1%, dividends, interest and rent account for 14.3%, transfer payments are 11.4%, and another 7% is the result of (net) income earned in other states by residents of New Jersey. This large contribution to personal income is due to the significant positive balance in income earned by New Jersey residents working in other states (mainly New York) compared to the smaller amount of income earned in New Jersey by residents of other states. The comparable percentages for this component of personal income for neighboring states are: Connecticut, 2.9%, Pennsylvania, .9%, and New York, -4.5%.

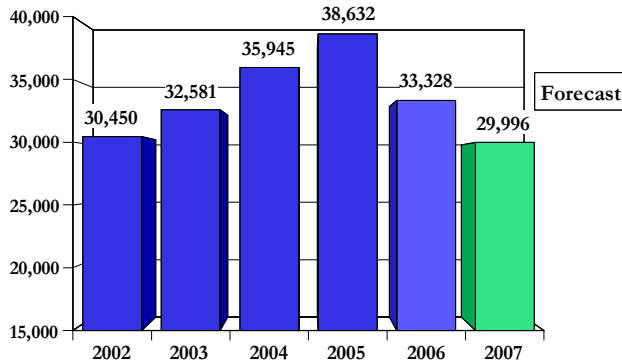


Housing

The housing sector, that former Energizer Bunny of the national economy for much of the current decade, finally ran out of battery power in 2006. The increase in home prices during the 2000 to 2005 boom far outstripped income gains and the resulting sharp decline in housing affordability was the key reason behind the unwinding of the housing sector. At the national level, there were significant declines in both new and existing home sales. Home price increases moderated from double-digit gains to barely positive, and in many local markets, prices fell significantly. Time on the market increased dramatically and the number of homes for sale soared. While there are some signs that the decline in the housing sector is stabilizing, this sector will not contribute to national economic growth for some time.

The performance of New Jersey's housing sector paralleled that of the nation. In 2006, sales of both new and existing homes declined by approximately 18% and the number of homes on the market increased by over 35%. This dramatic drop was based on the fact that house prices in New Jersey rose by an estimated 87% between 2000 and 2005, while median household income in the state grew by only 8.6%. This large disparity finally resulted in a significant decrease in affordability and housing demand. Once the market turned, market psychology kept the decline going. New housing permits in New Jersey fell by 13.7% in 2006 after rising steadily from 2000 to 2005.

NJ Residential Building Permits, No.



Consumer Prices

Inflation became the economic indicator of concern in 2006 as wage gains increased, unit labor costs rose, productivity tailed off, and energy prices soared and sank several times during the year. The Federal Reserve continued to focus its attention on the risks to the economy of any acceleration in inflation. Overall, for the year, the Consumer Price Index rose by 3.2% nationally. In New Jersey, the rate of increase was significantly higher at 3.8%, led by a 10% increase in energy, a 5.1% increase in housing costs, and a 4% increase in medical care. The overall 3.8% growth in the CPI in 2006 for New Jersey is slightly higher than last year's 3.7% pace.

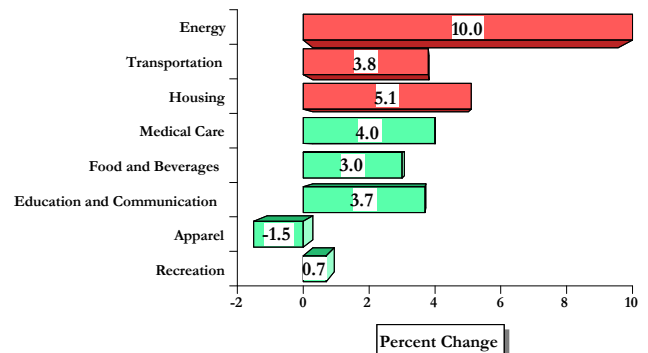
Vehicle Registrations



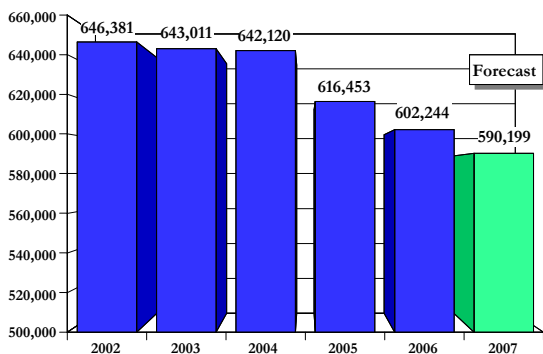
New vehicle registrations in New Jersey fell modestly in 2006, declining 2.3% from the previous year. New registrations are now down significantly from a peak of 646,381 in 2002. However, registrations remained near the still impressive 600,000 level for the year.

The sharp swing in gasoline prices along with the growing realization that long-term energy prices are likely to continue to rise, appears finally to be affecting American consumer preferences in a sustained manner in favor of fuel-efficient vehicles. The complex echo effects on the motor vehicle market of previous start-stop dealer incentive programs also affected sales in 2006. The strong growth in personal income in New Jersey, along with relatively low and stable interest rates, were positive factors supporting vehicle demand.

NY/NJ Consumer Price Index, by Expenditure Category, % Change 2005-06 Annual Average 2006 vs. Annual Average 2005 All Items = 3.8 %



New Jersey New Vehicle Registrations



(*Forecast value for 2006 based on data through November)

Construction Contracts



Construction contracts in both the residential and non-residential markets declined in New Jersey in 2006. Non-residential contracts fell by 11% last year although there are signs of improvement in activity in this sector. Rents and costs continue to soar in Manhattan and as a result, the competitive advantage of office expansion in New Jersey has improved. During the third quarter of 2006, there was a net absorption of nearly 1.9 million square feet of Class A office space in the 11-county Northern and Central New Jersey area. The overall vacancy rate for both direct and sublet space was about 18%, on a base of

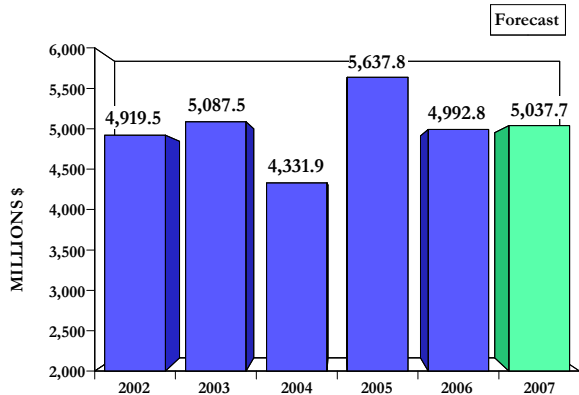


20.8 million square feet. The vacancy rate was 20.8% in the fourth quarter of 2005 on a base of 24.2 million square feet. Achieving stronger office job growth, however, remains key to any sustained improvement in commercial office space construction. Warehouse construction and distribution activity continues to improve based on significant increases in international trade.

International Trade

The past year was a blockbuster for international trade. American goods and services became more attractive to foreign buyers as economic growth improved abroad and the dollar depreciated. Over the year, the dollar fell by approximately 4% against other currencies on a trade-weighted basis. As a result, exports from New Jersey soared to over \$27 billion, a gain of over 28% for the year. Chemical products represented almost a third of the state's exports, while primary metals and computer electronics each contributed over 10%. Other major categories of exports were transportation equipment, machinery, and waste and scrap material. The major destinations for the state's exports were Canada (21.7%), the United Kingdom (7.9%), Mexico (6.5%), Japan (6.2%) and Germany (5.3%).

NJ Non-Residential Construction Contracts, \$

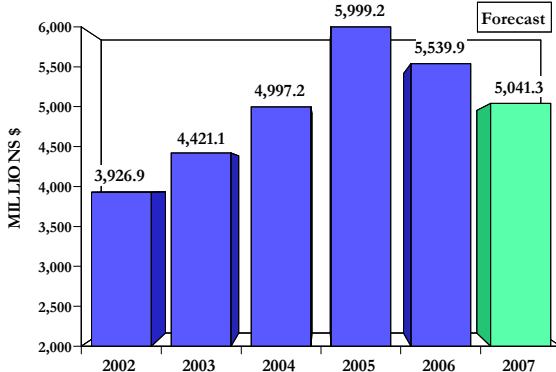


(Source: New Jersey Department of Labor)

Residential construction contracts also declined in 2006 due to increased inventories of homes for sale along with significant declines in sales volume and, in some local markets, prices. As a result, builders reduced construction and offered inducements of improved sale terms and various home features in an attempt to reduce inventory. The value of residential construction contracts fell by 7.6%. Although there are some signs of stabilization in the housing market, a further decline in residential construction contracts is expected this year. Mortgage rates remain attractive, but there is a significant inventory of both new and existing homes and home prices need to adjust further to improve housing affordability.

In addition, continued strong demand for imports kept New Jersey ports extremely busy. From 2000 to 2005, the amount of cargo (as measured by standardized 20 foot equivalent sized containers) handled by Port of New York/New Jersey increased by 57% to 4.8 million units. And strong growth continued in 2006. The sustained increase in cargo traffic has supported a significant expansion of warehousing, storage and distribution facilities in New Jersey in areas adjacent to the ports and north and south along the New Jersey Turnpike. Other transportation accessible sites in South Jersey along Interstate 295 and the Turnpike have also experienced significantly increased activity.

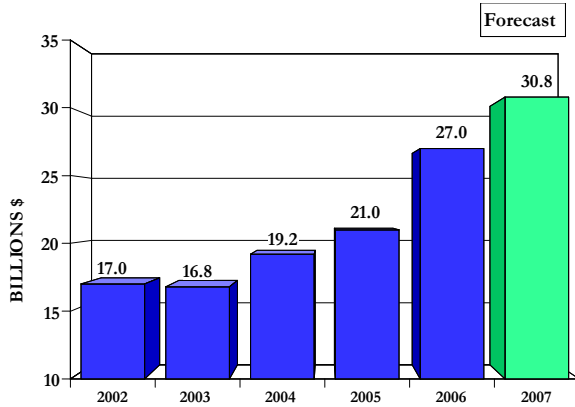
NJ Residential Construction Contracts, \$



Continued public infrastructure investment is necessary to maintain the competitiveness of New Jersey as a gateway for exports and imports. A caveat to this generally bright economic picture for New Jersey, and indeed for the nation, is the long-term sustainability of the large annual imbalances of U.S. international trade (a record \$763.6 billion deficit in 2006, up 6.5% over 2005). These deficits are responsible for the robust growth of inbound containerized cargo. The tonnage of imports into the Port of New York/New Jersey was 20.2 million metric tons in 2005, while the tonnage of exports was 7.9 million metric tons. This is a ratio of 2.6 tons of imports for every one-ton of exports.

NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2007

New Jersey Exports, 2002-2007
In \$ Billion

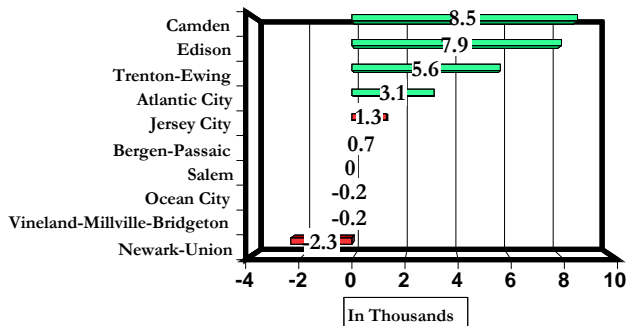


NJ Labor Markets



Employment growth varied across the state's labor markets in 2006. Job gains were highest in the Camden (8,500), Edison (7,900), and Trenton-Ewing (5,600) labor markets. Job growth was also positive in the Atlantic City labor market (3,100) and the Jersey City labor market (1,300). Employment was mostly unchanged in other labor markets, except for the Newark-Union labor market, which lost 2,300 jobs.

New Jersey Labor Market
Non-Ag Payroll Employment Change, 2005-06
(In Thousands)



NJ COUNCIL OF ECONOMIC ADVISORS

About the Council of Economic Advisors:
Established by law in 1993 (P.L. 1993, Chapter 149).

The Council is an advisory organization reporting directly and independently to the Executive branch of government, the Legislature and the public.

The Council prepares an Annual Report and a mid-year Report analyzing current New Jersey economic conditions and forecasting future developments, assists the Governor's Office in the preparation of the annual budget message, and advises the Governor and Legislature on public policies affecting the State's economy.

The Council consists of a Chairman appointed by the Governor and several legislative appointees.

The Council members are:

Dr. Joseph J. Seneca, Chairman
Members: Steven K. Brisgel, Victor H. Boyajian, Esq.,
C. Mark Dadd, Frederick Kelly, PhD.,
George Zoffinger

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NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2007

<i>(Current \$ or Nos.)</i>	2001	2002	2003	2004	2005	2006	Forecast 2007 ¹
Gross State Product (bill \$)	362.3	372.7	388.6	410.3	430.8	452.7	475.4
Personal Income (bill \$)	333.0	337.8	343.4	363.8	382.0	405.3	428.4
Retail Sales (bill \$)	105.0	106.7	109.4	116.1	121.7	127.6	134.0
New Vehicle Registrations (000)	655.5	646.4	643.0	642.1	616.5	602.2	590.2
Non-Res. Construction Contracts (mill \$)	5,017.6	4,919.5	5,087.5	4,331.9	5,637.8	4,992.8	5,037.7
Residential Building Permits (No.)	28,277	30,450	32,581	35,945	38,632	33,328	29,996
Res. Construction Contracts (mill \$)	3,885.7	3,926.9	4,421.1	4,997.2	5,999.2	5,539.9	5,041.3
CPI (1982-1984=100) ²	187.1	191.9	197.8	204.8	212.7	220.7	228.2
Employment ³							
Total Nonfarm (000) ⁴	3,989.0	3,970.5	3,983.6	4,023.4	4,051.6	4,085.5	4,118.2
Manufacturing (000) ⁵	381.9	358.3	344.4	334.3	327.4	320.7	312.0
Private Service-Providing (000) ⁶	2,828.7	2,833.8	2,852.1	2,875.4	2,906.1	2,938.2	2,967.6

Percentage Change from previous year:	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
(Current \$ or Nos.)						
Gross State Product	2.9	4.3	5.6	5.0	5.1	5.0
Personal Income	1.4	1.7	5.9	5.0	6.1	5.7
Retail Sales	1.6	2.5	6.1	4.8	4.9	5.0
New Vehicle Registrations	-1.4	-0.5	-0.1	-4.0	-2.3	-2.0
Non-Res. Construction Contracts	-2.0	3.4	-14.9	30.1	-11.4	0.9
Residential Building Permits	7.7	7.0	10.3	7.5	-13.7	-10.0
Res. Construction Contracts	1.1	12.6	13.0	20.1	-7.7	-9.0
CPI (1982-1984=100)	2.6	3.1	3.5	3.9	3.8	3.4
Employment						
Total Nonfarm	-0.5	0.3	1.0	0.7	0.8	0.8
Manufacturing	-6.2	-3.9	-2.9	-2.1	-2.0	-2.7
Private Service-Providing	0.2	0.6	0.8	1.1	1.1	1.0

1. 2007 forecast by the NJCEA.

2. CPI for NY-NJ-CT-PA metropolitan area.

3. Employment figures for 2001-2006 are seasonally adjusted December totals.

4. Total nonfarm employment for 2002 and 2003 has not yet been revised according to the 2006 benchmark.

5. Manufacturing employment for 2002, 2003, and 2004 has not yet been revised according to the 2006 benchmark.

6. Private service-providing employment for 2002, 2003, and 2004 has not yet been revised according to the 2006 benchmark.

OFFICE OF LEGISLATIVE SERVICES

The Office of Legislative Services provides nonpartisan assistance to the State Legislature in the areas of legal, fiscal, research, bill drafting, committee staffing and administrative services. It operates under the jurisdiction of the Legislative Services Commission, a bipartisan body consisting of eight members of each House. The Executive Director supervises and directs the Office of Legislative Services.

The Legislative Budget and Finance Officer is the chief fiscal officer for the Legislature. The Legislative Budget and Finance Officer collects and presents fiscal information for the Legislature; serves as Secretary to the Joint Budget Oversight Committee; attends upon the Appropriations Committees during review of the Governor's Budget recommendations; reports on such matters as the committees or Legislature may direct; administers the fiscal note process and has statutory responsibilities for the review of appropriations transfers and other State fiscal transactions.

The Office of Legislative Services Central Staff provides a variety of legal, fiscal, research and administrative services to individual legislators, legislative officers, legislative committees and commissions, and partisan staff. The central staff is organized under the Central Staff Management Unit into ten subject area sections. Each section, under a section chief, includes legal, fiscal, and research staff for the standing reference committees of the Legislature and, upon request, to special commissions created by the Legislature. The central staff assists the Legislative Budget and Finance Officer in providing services to the Appropriations Committees during the budget review process.

Individuals wishing information and committee schedules on the FY 2008 budget are encouraged to contact:

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(609) 292-8030 • Fax (609) 777-2442**